forward-looking cost-based pricing that the Commission hoped a deregulatory, market-based approach to special access pricing would have achieved. Because special access prices are not at these levels, this comparison provides compelling evidence that special access rates need to be reinitialized and set at levels that would exist if the market were competitive. It also demonstrates that dramatic reforms of the Commission's special access pricing rules are warranted to ensure that rates stay competitive.

B. Previously Proposed Reforms Remain Valid

1. Special Access Prices Should Be Reinitialized at Cost-Based, Forward-Looking Levels Using State-Approved UNE Rates as Proxies and, as an Alternative, the Commission Could Invite BOCs to File Forward-Looking Cost Studies

As discussed above and in 2005, special access prices are far above forward-looking, cost-based levels; BOCs are earning unconscionable rates-of-return; pricing flexibility rules have backfired in that BOCs have used price cap relief to raise prices; and customers are being harmed by billions of dollars per year in overcharges. Accordingly, as part of permanent reform and as proposed in 2005, the Commission should reinitialize special access prices that would then be subject to modified price cap rules on a going forward basis. The Commission has already recognized that re-initialization may be necessary in the circumstances presented here because the current regulatory framework has failed to produce reasonable prices. In fact, it emphasized that to the extent that competition did not fully achieve the goal of moving access rates toward costs, "the Commission reserves the right to adjust rates in the future to bring them into line with forward-looking costs."[132]

As previously proposed,[133] special access prices should be reinitialized and set at forward-looking economic cost-based levels that are reflective of a competitive marketplace. Taking this approach would be consistent with the Commission's previous conclusion that "access charges should ultimately reflect rates that would exist in a competitive market" and that in a competitive market, rates should reflect forward-looking economic costs.[134] Stated differently, rates should not be established based on historical accounting costs, *i.e.*, embedded costs[135] because "forward-looking costs are generally viewed as more relevant to setting prices in a competitive market" whereas embedded costs are not.[136]

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[132] *Access Charge Reform Order*, ¶ 48; *see also Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps Access Charge Reform Price Cap Performance Review for Local Exchange Carriers*, CC Doc Nos. 96-262 & 94-1, Order, FCC 02-161, ¶ 13 (2002).

[133] *See* Joint CLECs 6/13/05 Comments at 17-24; Joint CLECs 7/29/05 Reply Comments at 39-43.

[134] *See Access Charge Reform Order*, ¶ 42.

[135] *Alenco Communications Co. v. FCC*, 201 F.3d 608, 615 (5th Cir. 2000) ("rates must be based not on *historical, booked costs*, but rather on *forward-looking, economic costs*. After all, market prices respond to current costs; historical investments, by contrast, are sunk and thus ignored").

[136] *Special Access NPRM*, ¶ 65 (explaining that "[e]mbedded costs are associated with past business decisions and generally are irrelevant to a rational profit-maximizing firm operating in a competitive market; only forward-looking costs matter to such a firm with regard to business decisions that it is required to make today.") (citing *See* Alfred E. Kahn, Timothy J. Tardiff, & Dennis L. Weisman, *The Telecommunications Act at Three Years: An Economic Evaluation of Its Implementation by the Federal Communications Commission*, 11 INFO. AND ECON. POLICY 319, 324-25 (1999) ("Among economists, there is widespread agreement in principle that (1) the costs that would be the basis for efficient prices would be forward-looking, rather than historical and (2) the prices set on that basis should emulate the ones that would emerge from local exchange competition, if it were feasible."); Armen A. Alchian & William R. Allen, EXCHANGE

While the forward-looking methodology that should be used could prompt debate, the Commission should take a pragmatic and easily administrable approach at this point. This would involve setting special access prices at state-approved TELRIC prices for comparable UNEs, rather than setting entirely new rates for BOCs' special access services based on comprehensive and detailed forward-looking cost studies. This approach is a less burdensome and straightforward method of setting initial rates because it does not require cost studies or an extensive and expensive rate investigation.

In addition, although perhaps not the only acceptable forward-looking approach, TELRIC is a pricing approach already approved by the Commission (and the Supreme Court). While TSLRIC pricing methodology may also be acceptable, under both TSLRIC and TELRIC-based pricing methodologies,[137] prices reflect forward-looking economic costs, including a reasonable

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AND PRODUCTION 222 (3d ed. 1983) ("Once [an item] is acquired, [its costs are] irrelevant to the setting of price in competitive markets."); N. Gregory Mankiw, PRINCIPLES OF ECONOMICS 291 (1997) ("The irrelevance of sunk costs explains how real businesses make decisions."); Paul A. Samuelson & William D. Nordhaus, ECONOMICS 167, (16th ed. 1998)).

[137] The Commission previously held that "Prescribing TSLRIC-based access rates would be the most direct, uniform way of moving those rates to [forward-looking economic] cost" indicative of a competitive marketplace. *Access Charge Reform Order*, ¶ 289. TSLRIC stands for "total service long run incremental cost" and "total service" refers to the entire quantity of the service (either single service or a class of similar services) that a firm produces, along with the costs of dedicated facilities and operations used in providing that service. *See Local Competition Order*, ¶ 677. "TELRIC rates" are rates for unbundled network elements and interconnection based on TELRIC cost assumptions. The FCC coined and adopted the term TELRIC in the *Local Competition Order* to describe a different version of that methodology, one based on the specific network element or elements to be priced. *Local Competition Order*, ¶ 678 (discussing both methodologies). Essentially, TELRIC is an unbundled version of TSLRIC methodology, pricing discrete network elements rather than entire services. The Commission has concluded that "in practice" TELRIC "prices are based on the TSLRIC of the network element."[137] *Local Competition Order*, ¶ 672.

allocation of forward-looking joint and common costs, and permit ILECs to earn a fair, risk-adjusted rate-of-return on their investments.[138]

Employing TELRIC costing principles is bolstered by the fact that the Commission is very familiar with the TELRIC-based UNE rates BOCs charge. In fact, when it was considering their 271 applications, the Commission has extensively reviewed and examined them. During the § 271 proceedings and in approving all the § 271 applications, the Commission found, with minimal exceptions, that the state commissions followed basic TELRIC principles and established UNE rates that reflected the forward-looking economic cost of providing those elements.[139] While the Commission did not conduct *de novo* reviews of state commission TELRIC pricing determinations, it approved the applications so long as the UNE rates were within a zone that a reasonable application of TELRIC would produce.[140] Hence, the Commission can be confident that state commission-approved UNE prices closely approximate the forward-looking levels that would otherwise exist in a competitive market.

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[138] *1996 Access Charge Reform NPRM*, ¶ 222; *Local Competition Order*, ¶ 672.

[139] *See Local Competition Order*, ¶¶ 672-78; 47 C.F.R. §§ 51.501 *et seq.* (1999).

[140] *See, e.g., Application by SBC Communications Inc., Pacific Bell Telephone Company, and Southwestern Bell Communications Services Inc., for Authorization To Provide In-Region, InterLATA Services in California*, WC Docket No. 02-306, Memorandum Opinion and Order, 17 FCC Rcd 25650, ¶ 71, Appendix C ¶ 45 (2002). To determine whether UNE rates are "outside the range that the reasonable application of TELRIC principles would produce," the Commission undertakes comparisons of rates in the applicant's state to rates it has previously found to be TELRIC-compliant in another state. *See id.*, ¶¶ 54 & 71; *see also Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, CC Docket No. 00-217, Memorandum Opinion and Order, 16 FCC Rcd 6237, ¶¶ 81-82 (2001) *aff'd in part, remanded in part sub nom. Sprint Communications Co. v. FCC*, 274 F.3d 549 (D.C. Cir. 2001).

Because UNE prices are state-specific, they are inherently granular and exemplify forward-looking costs associated with providing facilities in each state. If the Commission prefers not to establish state-specific rates, it could establish a weighted average of UNE rates across a BOC region. Taking this latter approach may be unnecessary, however, because it appears that BOCs are already assessing state-specific special access rates as a result of pricing flexibility[141] and thus, requiring BOCs to assess state specific UNE rates for special access service would not be burdensome for BOCs to implement.

Another pro-competitive reason for setting special access rates at UNE rate levels is that doing so will encourage BOCs to operate in a cost-effective manner as a competitive market requires. Indeed, just as TELRIC provides BOCs with an incentive to operate in a forward-looking least-cost fashion, special access rates that reflect similar assumptions would pressure them to operate in a similar manner because they would only be allowed to recover efficiently incurred costs.

For the foregoing reasons, special access prices should be set at state-approved UNE prices. It is the most readily available forward-looking pricing approach and involves a minimum of burden on all parties concerned. If the Commission is considering other alternatives, state-approved UNE rates could also be used initially as a proxy for some other forward-looking approach that the Commission might choose as a permanent solution. If the BOCs, however, believe that TELRIC rates do not cover their costs, the Commission could invite them to file forward-looking cost studies instead. The Commission previously permitted

[141] *See* Declaration of M. Joseph Stith (dated Oct. 4, 2004) (filed in RM-10593 Dec. 7, 2004), Attachment 1 & 2 (comparing, among other things, the different pricing flexibility rates for DS1 and DS3 services BOCs assess in each state).

the BOCs to do this (which the BOCs chose not to do) instead of opting for other alternatives that were available to them.[142]

2. Price cap rules need to be refined

Once special access rates are reinitialized, as previously proposed,[143] the Commission should include all special access rates under a modified price cap regulatory framework.[144] The permanent features of this regulatory framework, which are highlighted below, should include a productivity-based X-factor, revenue sharing, as well as the service baskets and categories proposed by Joint CLECs.[145]

The X-Factor Should be Reapplied. The record fully supports imposing an X factor because BOCs enjoy productivity levels significantly greater than the economy as a whole.[146] Recent data from the Bureau of Labor Statistics further supports using an X factor and shows that for the period from 1996 through 2005, overall U.S. productivity growth averaged 2.8% per year,[147] while the wired telecommunications sector exceeded that by a considerable margin –

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[142] *CALLS Order*, ¶¶ 29, 56-62; *Special Access NPRM*, ¶ 14.

[143] *See* Joint CLECs 6/13/05 Comments at 24-32; Joint CLECs 7/29/05 Reply Comments at 43-55.

[144] This involves bringing all special access services in existing Phase II MSAs back within price caps.

[145] *See* Joint CLECs 6/13/05 Comments at 24-32; Joint CLECs 7/29/05 Reply Comments at 43-55.

[146] Verizon 6/13/05 Comments at 43, n.30; SBC 6/13/05 Comments at 40-42.

[147] United States Department of Labor, Appendix Table 1. Business sector: Revised productivity, hourly compensation, and unit labor costs, and prices, seasonally adjusted, *available at* http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?request_action=wh&graph_name=PR_lprbrief. To arrive at this figure, the average percentage of the reported year-to-year index growth was calculated over the years 1996 through 2006.

growing an average of 4.6%.[148] Because LEC productivity continues to outpace that of the economy as a whole, the Commission should neither set the X-factor at the inflation rate[149] nor reduce it to zero.[150] Such changes would mean that BOC customers would see none of the benefits of productivity gains, which would continue to accrue to the BOCs as monopoly rents.[151]

If anything, the record supports an X factor that is much higher than the 5.3% factor that applied previously. The two X-factor studies undertaken by Ad Hoc's economic consultants, Economics and Technology, Inc. and filed in this proceeding demonstrate that the Commission should adopt an X factor in the range of 10-11 percent.[152] Although the Commission should, at a minimum, apply the X-factor prospectively, it should also apply it retroactively back to 2004,[153] when the Commission, under the CALLS Plan, effectively eliminated the X-factor and froze the Price Cap Index ("PCI").

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[148] United States Department of Labor, Industry Productivity Costs, Wired Telecommunications Carriers, *available at* http://data.bls.gov/cgi-bin/surveymost?ip. To arrive at this figure, the average percentage of the reported year-to-year index growth was calculated over the years 1996 through 2002.

[149] Verizon 6/13/05 Comments at 41-43.

[150] Qwest 6/13/05 Comments at 10.

[151] *See, e.g.* Joint CLECs 6/15/06 Comments at 24-26; T-Mobile 6/13/05 Comments at 21-22; Nextel 6/13/05 Comments at 18-20; Sprint 6/13/05 Comments 12-13.

[152] Ad Hoc 7/29/05 Reply Comments, at 19-23; Ad Hoc 7/29/05 Reply Declaration of Susan Gately, at 4-8.

[153] Since substantial evidence demonstrates that special access rates are unreasonable, such retroactive true-ups would be permissible. *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 384, 387-89 (1932) (A carrier charging a merely legal rate (in that it was properly filed) may be subject to refund liability if customers can later show that the rate was unreasonable. Should an agency declare a rate to be lawful, however, refunds are thereafter impermissible as a form of retroactive ratemaking).

Revenue Sharing Should be Re-Imposed. In 1997, the Commission eliminated the sharing requirement based on its predictive judgment that the pace of *expected* competitive entry would obviate the need for sharing;[154] however, this did not turn out to be the case. Sharing is important as a correction for a miscalculated X-factor, and that a "zone" structure like before is appropriate.[155]

The BOCs cannot reasonably argue that they are being deprived of justly earned returns in the sharing zone, because if the market were as competitive as they claim it to be, *they would never have seen this level of return in the first* place. Moreover, whatever incentive the BOCs derive from supra-competitive returns is of no use to carrier consumers if all of the financial benefits of those incentives accrue as windfalls to the BOCs. As the Commission stated in the *LEC Price Cap Order*, "this level of sharing will ensure that consumers receive their fair share of productivity gains that occur, just as they would in an industry with keener competition."[156]

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[154] *1997 Price Cap Review Order*, ¶¶ 150-151 (emphasis supplied).

[155] The undersigned competitive carriers do not propose any sharing thresholds but believe that the thresholds the Commission previously adopted in the *LEC Price Cap Order* are appropriate if the outdated 11.25 percent rate of return is utilized. Specifically, in the *LEC Price Cap Order*, the Commission established three earnings sharing zones based on specific rates of return. *LEC Price Cap Order*, ¶¶ 122-26. In the first zone, price cap LECs were allowed to retain all of their earnings up to the first rate of return ceiling, 12.25 or 13.25 percent, depending on whether the LEC elected a 3.3 or 4.3 percent productivity factor. *LEC Price Cap Order*, ¶¶ 123, 126. In the second zone, price cap LECs were allowed to retain 50 percent and return to ratepayers 50 percent of their earnings between the first ceiling and the second ceiling, 16.25 or 17.25 percent, again depending on whether the LEC elected a 3.3 or 4.3 percent productivity factor. *LEC Price Cap Order*, ¶¶ 124, 126. In the third zone, price cap LECs were required to return 100 percent of any earnings above the second ceiling. *LEC Price Cap Order*, ¶¶ 125-26. If the Commission concludes that the rate of return should be lowered (as it should), the above sharing thresholds should be lowered commensurately. The productivity factors should be increased since the productivity of the wired telecommunications sector is 4.6%, which is far exceeds the overall U.S. productivity growth of 2.6%.

[156] *LEC Price Cap Order*, ¶ 124.

Moreover, without some type of limiting rules, price cap LECs will continue to earn windfall profits indefinitely, perhaps mitigated only by any applicable X-factor.

Baskets and Categories Proposed by Joint CLECs Should Be Adopted. For the reasons provided in 2005 comments,[157] the Commission should modify its current basket and category structure and adopt the Joint CLECs' proposal that establishes separate baskets for DS1 and DS 3 special access services and creates four categories within these baskets: (1) special access channel terminations between the LEC end office and the customer premises (*i.e.*, loops); (2) channel mileage between LEC central offices (*i.e.*, transport); (3) special access channel terminations between the IXC POP and the LEC serving wire center (entrance facilities) and (4) any other special access product related to the basket.[158] High capacity services above the DS-3 level (*e.g.*, OCn) should be placed in a separate basket that does not include categories insofar as the Commission's determination is correct that the market for these services is competitive.[159] Also, other retail services should have their own basket as well.

Moreover, the Commission should also establish a separate basket for mass market broadband and DSL services. As Joint CLECs previously showed,[160] these services compete directly with mass market cable offerings, existing in a duopoly that is currently fiercely price

[157] *See* Joint CLECs 6/13/05 Comments at 28-32; Joint CLECs 7/29/05 Reply Comments at 50-54.

[158] The 5 percent upper pricing band that currently applies to special access services and categories should also apply to the baskets and categories being proposed herein "to protect ratepayers from substantial changes in services rates." *See LEC Price Cap Order,* ¶¶ 223-24; 47 C.F.R. § 61.47(e).

[159] *See, e.g., TRO,* ¶¶ 315 & 389.

[160] *See* Joint CLECs 6/13/05 Comments at 30-31; Joint CLECs 7/29/05 Reply Comments at 51-52.

competitive, unlike traditional special access services.[161] If BOCs want to compete for these mass market customers, they should not be offsetting lower prices for competitive services by assessing higher rates for non-competitive special access services. To prevent such anticompetitive cross subsidization, the costs and revenues associated with mass market broadband and DSL services should be assigned to a separate basket.

As a general matter, implementing certain safeguards that prevent cost shifting from competitive services to non-competitive services is necessary to foster competition for telecommunications services. The Commission has long realized that separation of services into baskets is important. As it explained in the *LEC Price Cap Order,* "[s]ubdividing LEC services into baskets substantially curbs a carrier's pricing flexibility, as well as its ability to engage in unlawful cost shifting between the broad groups of services. Whenever a set of rates is subject to a price ceiling, carriers have no incentive to shift costs into the basket because the cap does not move in response to endogenous cost changes."[162]

Consistent with these Commission observations, the Joint CLECs' proposal appropriately segments the most relevant and recognized special access product markets to preclude cost shifting between such broad groups of services. In addition, the categories proposed for the DS1 and DS3 baskets, which would be subject to rate ceilings, would minimize the BOCs ability to offset rate reductions where there is competition with rate hikes between and among the various categories where there is none. Through such regulation, the Joint CLECs' proposal will protect

[161] *Special Access NPRM,* ¶ 52.

[162] *LEC Price Cap Order*, ¶ 200.

and hopefully foster competition. For these reasons, the Commission should establish baskets and categories as the Joint CLECs propose.[163]

3. The Commission Should Abolish Phase II Pricing Flexibility

The Commission should abolish Phase II pricing flexibility.[164] The fact that BOCs, as demonstrated above, have been raising prices throughout MSAs where Phase II pricing flexibility has been granted, by itself shows that the Commission's Phase II pricing flexibility tests misidentify where competition is sufficient to constrain prices. If those tests accurately identified where competition could replace regulation as the guarantor of reasonable prices, BOCs would have reduced or maintained prices. In fact, customers have received no benefits from Phase II pricing flexibility. Even if prices have remained the same in some cases, customers have been harmed because service in those areas has not been subject to any X Factor reductions that would have been permitted customers to obtain the benefits of increased technological efficiencies. Phase II pricing flexibility, especially after the expiration of the CALLS plan, has been a huge windfall for price cap ILECs.

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[163] To the extent the Commission is disinclined to establish the additional baskets that the undersigned competitive carriers propose (ostensibly out of concerns that the BOCs would not be able to achieve the total company productivity offset for each basket), the Commission should, at a minimum, establish separate "categories" for each of the baskets and "subcategories" for each of the proposed categories . The 5 percent upper pricing band that currently applies to special access service categories and subcategories should apply to these new categories and subcategories so that ratepayers are protected "from substantial changes in service rates." *LEC Price Cap Order*, ¶¶ 223-24; 47 C.F.R. § 61.47(e). The Commission took such an approach in *LEC Price Cap Order*. *Id.*, ¶ 210.

[164] *See* Joint CLECs 6/13/05 Comments at 32-35; Joint CLECs 7/29/05 Reply Comments at 55-57.

BOCs' pricing responses to Phase II pricing flexibility have invalidated the Commission's prediction that relieving special access service from price cap regulation in qualifying MSAs could "lead to higher rates for access to some parts of an MSA that lack a competitive alternative...."[165] The Commission also recognized that "the regulatory relief we grant upon a Phase II showing may enable incumbent LECs to increase access rates for some customers."[166] Price increases that BOCs have been able to implement because of the absence of competitive alternatives has not, however, been confined to "some parts of an MSA" or some customers as the Commission contemplated. Rather, price increases have occurred throughout the MSA qualifying for Phase II pricing flexibility.

The Commission also erroneously believed that Phase II relief was justified because its price cap rules may have required incumbent LECs to price access services below cost in certain areas.[167] If this unsupported 1999 speculation about below cost pricing was ever valid, it since has been invalidated by the astronomical rates-of-return that BOCs are earning on special access service. There is no realistic possibility that BOCs are providing special access service below cost anywhere. Thus, the Commission's concern about the theoretical possibility of below cost pricing does not now, if it ever did, justify a regulatory scheme that permits widespread price increases of the type that BOCs have implemented.

There is no basis, in any event, for a regulatory framework governing special access that permits BOCs to increase prices based on a showing of competition. Competition should put downward pressure on prices. BOCs have no reason to raise prices in response to competition,

[165] *Pricing Flexibility Order*, ¶ 142.

[166] *Pricing Flexibility Order*, ¶ 155.

[167] *Id.*

except the anticompetitive tactic of raising prices where there is no competition to offset predatory pricing in other areas. Allowing BOCs to raise prices in response to competition has no theoretical basis and invites abuse. The Commission should abolish Phase II pricing flexibility or provide that BOCs may only reduce prices.

C. The Commission Should Find that Volume Discounts May Not Be Subject to Unreasonable and Restrictive Conditions

As noted, the record already demonstrates that BOCs impose unreasonable conditions on volume discounts, including region-wide commitments, conditioning discounts on the level of prior purchases, and limits on the purchase of UNEs or competitors' services.

The Commission should establish, pursuant to Section 201 of the Act, that price cap ILECs may not impose any conditions on volume and term discounts that are not reasonably related to costs or efficiencies of providing volume or term offerings. BOCs should be limited to offering discounts that are tied only to the volume and term purchased. Discounts would be provided on a sliding scale basis as volume and term commitments increased.[168] They should not be based on total company special access commitments to an RBOC or other unreasonable terms such as those the GAO found to inhibit competition or otherwise limits customers' ability to choose another provider. As discussed above, the GAO found, "[t]hese conditions include such things as revenue guarantees, requirements for shifting business away from competitors, and severe termination penalties." "These types of contracts…inhibit choosing competitive alternatives because the customer does not receive the applicable discount, credit, or incentive if the revenue targets are not met and additional penalties may also apply."[169] As the GAO

[168] *See* Comments of AT&T Corp., WC Doc. 05-25, at 7 (filed June 13, 2005).

[169] GAO Report at 30.

concluded, "[u]nless a competitor can meet the customer's entire demand, the customer has an incentive to stay with the incumbent and to purchase additional circuits from the incumbent, rather than switch to a competitor or purchase a portion of their demand from a competitor—even if the competitor is less expensive."[170]

The bottom line is that the Commission should conclude these unreasonable BOC contracts are unlawful because they inhibit customer choice and competition. By rendering such a decision, the Commission would promote the provision of the most cost-effective and innovative services because customers would be free to move to other special access providers based on better price or superior technology instead of being locked in by non-cost-based terms and conditions.

D. The Commission Should Adopt a "Fresh Look"

Assuming that the Commission determines that BOCs may not impose conditions on discounts that are not reasonably related to costs or possible efficiency gains, it should also establish a fresh look so that customers locked in by current unreasonable BOC tariffs or contracts may choose another provider. Absent a fresh look opportunity, BOCs will essentially be able obtain the benefit of anticompetitive conditions for an extended period of time throughout their regions, thwarting the Commission's determination that those conditions are unreasonable and unlawful. An effective fresh look opportunity must permit customers to terminate a contract without penalties. The fresh look opportunity should be at the sole election of the customer. The BOC should not have the option to terminate existing contracts because it could use this option to harm customers by imposing on them in an arbitrary fashion the burdens

[170] GAO Report at 30.

of undertaking new contract negotiations and/or finding alternative providers. Accordingly, the Commission should determine that customers, at their election, may choose to terminate service without penalties. Commenters suggest a fresh look period for this purpose of one year during which customers may, without incurring penalties, choose an alternative provider or negotiate a new arrangement with the BOC.

V. CONCLUSION

The Commission should promptly grant the requested relief.

Respectfully submitted,

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Penn Telecom, Inc.
RCN Telecom Services, Inc.
SAVVIS, INC.
U.S. Telepacific Corp. d/b/a Telepacific Communications

Dated: August 8, 2007

ATTACHMENT 1

DECLARATION OF DON EBEN

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593

DECLARATION OF DON EBEN

1. My name is Don Eben. I am Director of Network Planning of McLeodUSA Telecommunications Services ("McLeodUSA"). My business address is 15 E. 5th Street, Suite 1600, Tulsa, OK 74103. I joined McLeodUSA in April 2001. I have more than 11years experience in Network Planning and Engineering with responsibilities including contract negotiations, cost management, and network architecture. I have factual knowledge relating to the information discussed in this Declaration.

2. I am responsible for Access Planning and implementation. As part of my responsibilities, I have been personally involved in overseeing efforts to implement McLeodUSA's policy to build loop and other facilities where economically possible, or to obtain them from non-ILEC providers where available. The purpose of this declaration is to demonstrate the lack of alternatives to BOC facilities to the vast majority of end user customer locations.

3. Wherever possible, McLeodUSA seeks to rely on its own facilities for provision of service. McleodUSA has invested over $ 3 billion in network facilities including switches, transport facilities, long-haul fiber, and in rare instances, OCn loops to customer premises. McLeodUSA has either built these facilities or acquired them from other carriers.

4. It is my experience that it is rarely economically feasible for McLeodUSA to build the last mile connections (*i.e.*, loops) at the DS0, DS1, or DS3 capacity level to individual premises. The revenue that can be derived from the required investment in such facilities will, in all but a few rare exceptions, not be adequate to recoup the investment costs and provide a return on that investment. Moreover, even in the rare instance where it may be economically feasible to make the initial investment to serve a particular premise, the difficulty in obtaining the necessary rights of way or building access permission in a timely manner to accomplish the construction of the direct connection creates another insurmountable barrier.

5. Where it is economically infeasible to construct facilities, McLeodUSA has a preference to obtain facilities from competitive providers. McLeodUSA will purchase services from ILECs only as a last alternative. However, it is my experience in every market in which it operates that McLeodUSA is never able to obtain raw copper facilities to any customer location from competitive providers. I am also not aware that McLeodUSA is able to obtain DS0 level loop facilities to premises from any competitive providers. McLeodUSA is able to obtain DS1 and DS3 level access from competitors to no more than 5% of customer locations. Where McLeodUSA is unable to construct facilities, or obtain them from competitors, McLeodUSA must obtain them from ILECs either as UNEs or special access. McLeodUSA is dependent on reasonably priced ILEC facilities for access to customer locations in the vast majority of situations.

6. For reasons stated in my declaration in WC Docket No. 04-223, ILEC special access and "commercial" offerings do not provide a realistic business alternative for obtaining most transport and loop facilities.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed August 6, 2007

Don Eben

ATTACHMENT 2

DECLARATION OF KEVIN ALBAUGH

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593

DECLARATION OF KEVIN J. ALBAUGH

1. My name is Kevin J. Albaugh. I am Vice President, Regulatory of Penn Telecom, Inc. My business address is 4008 Gibsonia Road, Gibsonia, Pennsylvania 15044. I joined Penn Telecom in 1996. I have over 30 years of experience in the telecommunications industry. During that time I have held management positions of increasing responsibility in the area of sales, rates and tariffs, revenue requirements, intercompany relations and regulatory policy. During that period, I was employed by a number of incumbent local exchange carriers including Mid-Continent Pennsylvania, Alltel-Northeast Region and finally North Pittsburgh Telephone Company (NPTC). NPTC is an affiliate of Penn Telecom, Inc. At NPTC I am also the Vice President of Regulatory Affairs with duties similar to those that I provide for Penn Telecom, Inc. I have factual knowledge relating to the information discussed in this Declaration.

2. Penn Telecom is an edge-out CLEC that operates exclusively in the Pittsburgh MSA. The company is headquartered in Cranberry Twp., PA and employs 125 people. Our product portfolio includes traditional local and long distance service, 800 service, calling cards, PRIs, DSL, Internet access, broadband data, Metro-Ethernet and VoIP. Penn Telecom's primary

focus is on the small and medium enterprise space as well as a limited number of MDU developments.

3. Penn Telecom's value proposition is based on the fact that we are committed to providing quality telecommunications services in a single market at competitive prices. Through our association with our affiliate the incumbent local exchange carrier (ILEC) North Pittsburgh Telephone Company, we have been able to implement our edge-out strategy as we build out our network in a cost effective manner. By initially purchasing certain services, such as switching capability, from our ILEC affiliate, we have been able to leverage our ILEC affiliate's 100 year telecom legacy to establish ourselves as the home-town intramodal choice for competitive business services in the Pittsburgh metro market. Our high quality bundled voice and broadband data networking capabilities, especially our Metro-Ethernet services, are relatively unique in this market.

4. **[Begin Confidential] *** [End Confidential]** In those instances when unbundled network elements are unavailable, Penn Telecom will order the element via Special Access, but at a much greater cost.

5. **[Begin Confidential] *** [End Confidential]** The Pittsburgh MSA covers seven counties in Southwestern Pennsylvania. According to the U.S. Census Bureau 2002 Survey of Business Owners, there are 46,756 "employer firms" within the MSA. Penn Telecom's existing network does not cover the entire MSA, but does encompass those areas that have the most dense concentration of the business market that we address. Our focus is on the over 30,000 potential "employer firms" exist within the footprint of our operation. Since the Census Bureau defines an "employer firm" as one with a payroll, and therefore employees, we assume this category to be a fair indicator of the small and medium enterprise market in the Pittsburgh

MSA and therefore our potential addressable customer base. Even though Penn Telecom has chosen to serve those areas in the Pittsburgh Metro market that are most densely populated, still our customers are scattered across a large geography, resulting in a much lower density of customers served per square mile than that experienced by Verizon whose facilities benefit from being ubiquitous. This resulting low-density service market is not conducive to the economical construction of alternative facilities, especially by a single provider.

6. **[Begin Confidential] *** [End Confidential]**

7. **[Begin Confidential] *** [End Confidential]** Due to the highly competitive nature of the intramodal market and Verizon's ability to charge lower retail rates than the wholesale rates that Verizon has quoted to Penn Telecom for essentially the same facility, it would be impossible for Penn Telecom to recoup these increases through increases in retail pricing to end users. The competitive market has driven the retail prices down to the point that the cost of a single special access facility would exceed the total revenue available from most of the customers that we serve via DS-1 facilities. Except for the last mile loop bottleneck facilities that are owned and provisioned by Verizon and for which Verizon is able to charge exorbitant rates if unchecked by this Commission, there are no excessive margins in the Pittsburgh voice and broadband markets, especially with the prevalence of flat-rate, unlimited calling plans. Should Verizon be successful in eliminating intramodal CLEC access to these last mile local loop and DS-1 facilities at the lower unbundled network element rates, it is certain that Penn Telecom as well as other CLECs operating in the Pittsburgh Metro area would be unable to maintain any level of profitability while absorbing the drastically increased costs. Consequently Penn Telecom would be forced to scale back significantly, ceasing to serve most if not all of our small and medium enterprise customers. The result would be that these customers would no longer have

any viable choice other than Verizon for their voice and broadband services, essentially forcing them back to the single option of Verizon's retail services at higher rates.

8. Based on my experience at Penn Telecom and in the telecommunications industry, it will take some time for a fully competitive facilities-based environment to develop with more than two large players in each MSA. The capital costs necessary to achieve a truly independent network are staggering. While the costs of technology for both switching and transport do continue to decline, the market still lacks a viable alternative access network provider that can offer ubiquitous access over last mile loop facilities that will reach 100% of the addressable market. Obviously the most efficient approach is a neutral provider who can share the costs among many buyers. The requirement that Verizon continue to offer reasonably priced access to the unbundled loop and DS-1 facilities in the Pittsburgh market is a viable alternative in the meantime, until facilities based competitors can reach the scale necessary to serve the entire market.

9. The typical small business customer served by PTI has seen his or her rates for telecommunications services plunge by 20-50% since the introduction of competition in the Pittsburgh Metro market. This competition, however, is only viable in the small and medium enterprise space through the continued availability of the incumbent Verizon last-mile facilities at TELRIC justified prices. It is Penn Telecom's experience that the vast majority of the small and medium enterprise market is reachable only by reasonable access over Verizon facilities. Absent reasonable terms for access to Verizon last mile bottleneck facilities, Penn Telecom would be forced to cease providing service to many of our small customers, robbing them of any competitive choice.